

# **CENTER FOR ECONOMIC DEVELOPMENT**

## **BULGARIA AND THE LISBON AGENDA GOALS**

**March 2004, Sofia**

## **CONTENTS**

### **Introduction**

### **Overcoming Economic Lagging Behind**

### **In Pursuance of the Lisbon Goals**

#### **Transition to Knowledge-Based Economy**

*Legal framework for developing knowledge-based economy in Bulgaria*

*Information society in Bulgaria*

*Research and development*

#### **Toward Single Internal Market – Continuation of the Liberalization Process**

*Telecommunication sector*

*Energy sector*

*Competition in the transport sector*

*The fiscal services market*

#### **Encouragement of Entrepreneurship**

*Environment for start-up and development of enterprises in Bulgaria and reducing administrative and regulatory barriers to business*

*Shifting from state aid toward horizontal measures in support of enterprises and applying efficient competition protection policy*

#### **More and Better Jobs, Greater Social Cohesion**

*Encouragement of employment and fighting unemployment*

*Better education and qualification*

*Better social protection and cohesion*

### **Conclusion**

### **Appendices**

## Introduction

When in the spring of 2000 the European Council in Lisbon adopted a strategy for economic reform Bulgaria had just started negotiations for accession to the Union. There was consensus and clear desire in the society on the country's accession to the common European family but the state of the national economy and the processes underway were different then. Many tough reforms were to be completed before the Bulgarian economy could yield to the goals of the common European development. At that time the issue of the competitiveness of the economy as a whole and its components in particular was hardly beginning to be discussed and a number of the goals laid down in the Lisbon Strategy like promotion of innovations, encouragement of entrepreneurship, investing more funds in research and development were not on the agenda yet.

With the implementation of most of the underlying economic reforms, achievement of macroeconomic stability, consensus about major directions of economic policy and reinforcement of a functioning market economy the possibility for transitioning from including the goals of the Lisbon Programme on the agenda to their implemation gradually materialized. This requires transposition of the Lisbon goals to the specific conditions in the country and embedding them in developing the objectives and measures of the national economic policy.

A year ago the *Center for Economic Development* and the *British Embassy in Sofia* laid the ground for cooperation in assessing Bulgaria's readiness for achieving the goals of Lisbon. With the organization of the first conference "Bulgaria, Great Britain and the Lisbon Programme: Strategies for Increasing Employment and Productivity", we aimed to highlight the importance of the Lisbon Programme and the need to focus the attention of the Bulgarian society on achieving the goals laid down in the strategies for increasing employment and productivity. Then the focus was placed on the policy and the specific measures applied by the ministries in light of the Lisbon goals.

Now we have set ourselves a more ambitious task to bring into the attention of the society an overall *assessment of the implementation of the criteria laid down in the Lisbon Strategy* and to highlight the main successes and weaknesses as we move toward achieving its goals. Our intention is every year, during the days of the Spring European Council, to assess Bulgaria's progress in implementing the Lisbon goals and to inform the society about the results of this assessment. Thus we will contribute to Bulgaria's adequate integration in the overall assessments of the official and research institutions in Europe, analysing implementation of the common goals set.

## Overcoming Economic Lagging Behind

The main goal adopted by the Lisbon European Council for the period until 2010 is: “to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth, with more and better jobs and greater social cohesion.” To achieve this goal comparatively high levels of economic growth and employment should be maintained in the medium run and higher standards of living should be ensured. In numerical terms an average annual GDP growth of 3% is projected and by the end of 2010 employment is to reach 70%.

The main objective in macroeconomic policy is associated with *maintenance of macroeconomic stability and contribution of public finance to economic growth and employment*. This means reducing the level of government debt and constraining budget deficit.

In the Regular Report of the European Commission on Bulgaria’s progress towards accession to the EU in 2002 the country was recognized as a functioning market economy. The Report for 2003 states that “Bulgaria has achieved a high degree of macroeconomic stability and market mechanisms are working sufficiently to allow a more efficient allocation of resources”<sup>1</sup>.

Achieved stabilization of the macroeconomic framework and significant progress in structural reforms ensured a **comparatively high growth of the Bulgarian economy** against the background of global slowdown in economic growth. For a fourth consecutive year *GDP growth* exceeds 4%. By our estimates in 2003 GDP growth is 4.2% against 4.8% in 2002 and 4.1% in 2001. Growth is due both to dynamic domestic demand and higher foreign trade turnover. The ratio between turnover and GDP increased from 70% in 1999 to about 100% in 2003 (according to preliminary data). Against the background of a still slowly recovering global economy in 2003 **Bulgaria’s foreign trade made a serious step forward**. Growth in turnover (30.7% in exports and 35.9% in imports in dollar terms) is the highest in several years and the levels of exports and imports hit a record high since 1989. In lev terms (eliminating the impact of the low exchange rate of the dollar) growth is 9.9 per cent and 14.1 per cent respectively. This development is a good indicator of the improving state of the national economy and its competitiveness.

At the same time the sizeable trade deficit is considered a serious setback to the stability of the economy as a whole and its sustainable development in the future. The faster growth of imports and the negative trade balance are due to several major factors. First, this is **increased consumption**. Comparatively good incomes and growth in consumer credits in 2003 boosted consumption, which cannot be met mainly from domestic production at this stage. Second, growth in investments leads to faster **growth in imports** of investment goods and raw material feedstocks than total import growth (by 41.6% and 66.6% respectively). These imports account for 1/3 of total imports and have a long-term positive effect on the economy. The geographic structure of foreign trade outlines an increased share of EU: 57% in exports and 50% in imports.

The Bulgarian economy will continue to strengthen its positions on the European market and to rely on its competitiveness based on lower production costs. Competitiveness helped increase exports to the EU in a period of halted growth in the

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<sup>1</sup> 2003 Regular Report on Bulgaria’s progress in the accession process, p. 36.

European economy and contracted consumption on the single European market. Bulgarian exporters will benefit from equalized production conditions and higher prices of products in the new 10 member states (at least for some time).

The trade deficit is largely offset by the inflow of foreign investments. According to preliminary data, the total volume of **foreign direct investments** (FDI) for 2003 is estimated at USD1.361 billion. We expect their volume to approximate USD 2 billion after subsequent revision (to include reinvested profit). This is the biggest volume of FDI since 1992. Foreign companies in the country (or companies with foreign stake) have already completed their start-up period and are developing actively, creating good basis for attracting more domestic suppliers and providing export products. The new Investment Encouragement Bill proposed by the government determines new priority sectors that the government is interested to develop and in which investments will be made. The bill aims to ensure the legal framework for financing of infrastructure projects as part of the European infrastructure networks and conditions are provided for development of public-private partnership.

For the period 1999-2002 GDP per capita in dollar terms grew by 25.4%. Nevertheless, Bulgaria is lagging far behind EU income levels per capita. According to Eurostat data, **average income per capita remains well below that in EU**, although it grew from 24% on the average EU level (by purchasing power parity) in 1999 to 26.4% in 2002. Differences in income across the country are comparatively low - in 2001 income per capita in five of the regions varies between 83% and 91% of the average for the country and only in the Southwest region, including Sofia, does it exceed by 40% the average one. Projected GDP growth in the next two years (5 and 5.5% respectively) is twice higher as that in the EU and will allow for the average income per capita to reach 32%. Even if the accelerated GDP growth rate (compared with EU) sustains further, by 2010 the average income per capita will hardly reach 50% of that in EU. Obviously much more sizeable investments for substantial economic restructuring will be needed to lay the ground for higher growth rates and higher incomes. The latest report of the EC on Bulgaria's progress towards accession states that convergence of income and productivity with the levels achieved elsewhere in Europe will be a serious challenge for Bulgaria.

As regards *public finance*, implementation of tight fiscal policy continues. As a result of this policy in 2003 (for the first time since 1999) a **balanced budget** was achieved (deficit of 0.6% of GDP in 2002), combined with good execution of the consolidated fiscal programme, increased fiscal reserve, active debt management, ongoing decline in the debt/GDP ratio, higher credit rating of the country, positive changes in tax laws. The total amount of government and government-guaranteed debt decreased further: from 80.6% of GDP in 2000 to 56% in 2002 and 47.8% in 2003. This is a result mainly of the contraction of the foreign debt (from 73.7% of GDP in 2000 to 41.3% in 2003). In the foreign debt structure a sustainable trend evolved toward balancing the debt by currencies - dominating of Euro-denominated debt at the expense of the dollar-denominated one. Tax policy is directed toward limiting direct taxes at the expense of indirect ones. Restructuring of tax and customs administrations and establishment of a National Revenue Agency is underway. A process of fiscal decentralization is underway whereby specific responsibilities are shifted from central to local budgets. Still pending is the issue of the efficient use of public expenditures and their proper channeling to investments in physical and human capital to ensure fast economic growth.

The evolving dynamics of macroeconomic indicators in recent years is robust, given the not very robust performance of most European states. However, the extremely low starting point of Bulgaria should be taken into account. To catch up with the lagging behind much higher growth rates are needed, mainly through boosting competitiveness and efficiency at all levels of the economy. Adherence to the currency board and good macroeconomic policy creates the necessary basis for maintaining a comparatively high sustainable growth in the future. It will allow to achieve part of the criteria laid down in the Lisbon Strategy but will not be sufficient for other (e.g. incomes). These will take longer time to achieve or higher growth rates based on massive investment in high value added sectors.

## **In Pursuance of the Lisbon Goals**

Pursuant to the Lisbon Strategy enhanced competitiveness should be driven by *encouraging the innovation process, completing the formation of the single European market, entrepreneurship development and greater social cohesion*. Adhering to the goals set and the specific tasks to be addressed by the Bulgarian society, we focus on four major areas of impact: innovation process, further market liberalization, enterprise policy and social reform.

## **Transition to Knowledge-Based Economy**

One of the areas outlined by the Lisbon Strategy as a major driver of higher competitiveness of the economy and improved social status of the population is the transition to knowledge-based economy and creation of information society. Understandably, these goals require overall updating of legislation consistent with modern reality as well as providing broad access to the new information and communication technologies. As part of the initiative was the adopted plan eEurope (eEurope+), in which Bulgaria also took part. In addition, the strategy defined some major areas of work in which EU member states and the acceding countries have to focus their efforts in the next years. In general these are:

1. Providing access to cheap and quality telecommunication services and information to business and individuals.
2. Creating favorable conditions for development of e-commerce, e-government and supporting Internet penetration.
3. Full integration and liberalization of telecommunication markets.
4. Maintaining free competition in Internet supply to ensure higher quality and low price of the service.
5. Providing access to the World Wide Web to all schools as well as possibilities for use of ICT.
6. Providing electronic access for major public services.
7. Focus on the development of research and innovations:
  - better coordination and integration of research at national and international levels;
  - improving the environment for private investments in research and hi-tech companies.

Bulgaria has taken a number of steps in fulfilling the main goals of Lisbon Strategy.

*Legal framework for developing knowledge-based economy in Bulgaria*

First, this involves updating the legislation on ICT and research, combined with preparation and adoption of some obligatory elements of the shift to information society. The following major strategic documents concerning the development of *information society* (IS) were adopted:

- **Strategy and National Programme for Development of the Information Society in the Republic of Bulgaria** (adopted in October 1999). This is the underlying document in the IS area, providing comprehensive characteristics of the Bulgarian IS and recommendations for timely implementation of the objectives set. In general the two documents are in conformity with EU guidelines but delayed implementing of objectives is due to the lack of consistent policy and financial resources.
- **E--Government Strategy** (adopted in December 2002). The main objective in adopting the strategy is to organize and ensure high-level support by the government to the processes of providing electronic administrative services. Adoption of an action plan to the strategy was significantly delayed which reflected adversely on the development of the objectives laid down in the strategy and currently their implementation is at a very low level.
- **Strategy and Plan for Enhancing the Competitiveness of the Bulgarian Information and Communication (ICT) Sector on Global Markets** (adopted by the Council for Economic Growth in early 2004). The idea is to outline the general vision and agreement of the business and the government on development of ICT industry in Bulgaria and turning it into a driver for the country's economic development.

A number of new laws are being adopted and existing ones are being updated so that their content is in line with modern reality. Major changes include:

- Electronic Document and Electronic Signature Act (EDESA) effective as of 1 October 2001. It establishes the legal regulation of electronic documents and electronic signatures and the rules and conditions for providing ascertaining services. It has been drawn up in conformity with EU directives and reflects all requirements for secure e-commerce transactions and interaction with the e-government.
- Protection of Personal Data Act (PPDA) effective as of January 2002. It provides protection to individuals in respect of collection and processing of personal data as well as access to them. It is consistent with the commitments undertaken by Bulgaria in relation to harmonization of the legislation with the EU one in respect of human rights protection.
- Changes in the existing legislation aimed to address adequately the challenges of the modern world (computer crime, information abuse, etc.). The Criminal Code was updated in September 2002. A new chapter "Computer Crimes" was included, aimed to ensure protection to Bulgarian citizens and business against newly emerged cases of crimes in Internet and computer use. The changes are consistent with the Convention on Cyber Crimes of the Council of Europe, signed by Bulgaria in 2001.

- A new Telecommunications Act was adopted, guaranteeing liberalization of the telecommunications market and protection of user rights in the new situation in the sector. Although it is in conformity with the latest EU directives (adopted in 2003), the Bulgarian act follows the prescriptions of the earlier series of directives which in essence refer to the nascent state after liberalization of telecommunications – exactly reflecting our stage of market development.
- Updating the legislation on intellectual property. The Copyright and Neighboring Rights Act and the Patent Act were updated in 2003 in view of the changing situation in modern business world.

The Bulgarian government and business made immense efforts to create proper environment to ensure a knowledge-based economy and successful transition to the information society. Obviously almost all strategic instruments have been adopted, serving as a basis for the future development. In spite of the efforts however, work done so far represents the easier part of the road to achieving the Lisbon goals. Implementation of the measures and recommendations prescribed in the above-mentioned documents is the actual activity yet to be carried out in Bulgaria. This applies fully to the distribution of the electronic signature (related to revealing the potential of the e-government and e-commerce), actual achievement of competitive telecommunication market (despite the 5 licensed operators) and last but not least strict adherence to personal data protection (adoption of the act is not a guarantee for effective protection).

In addition, one of the specific tasks which Bulgaria should address in the following years is updating the Telecommunications Act in compliance with the EU directives on telecommunications adopted in 2003. This should be done after achieving actual competition on the communication market following intensification of operations of the newly licensed telecommunications companies.

### *Information society in Bulgaria*

**Bulgaria has made a significant progress in the development of the information society** over recent years. The tables below show data provided by the International Telecommunication Union, revealing the distribution of computers, fixed and mobile telephone networks and Internet. All indicators exhibit positive development in the recent years but the number of subscribers to mobile operators has posted a most sizeable increase (67.6% in 2002 and over 100% in the previous year).

Year	Total number of telephone subscribers (thousand)	Telephone subscribers (% of population)	Mobile subscribers (thousand)	Mobile subscribers (%)	Total number of telephone lines (thousand)	Telephone lines (%)
2000	3 619.8	44.42	738.8	9.06	2 881.8	35.36
2001	4 463.9	55.06	1 550.0	19.12	2 913.9	35.94
2002	-	-	2 597.5	33.3	2 868.2	36.77

Source: International Telecommunication Union ([www.itu.int](http://www.itu.int))

The number of Internet users in the country also increased (by over 4% in 2002/2001 and 40% in 2001/2000 r.). The jump in the period 2000/2001 is due to the



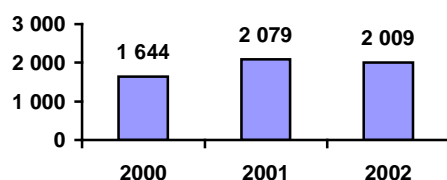
sharp fall in prices for Internet access as well as introduction of alternative and cheap means of access (mainly pre-paid cards). After 2001 an incremental increase followed (3-7% according to different sources). According to data from marketing agencies operating in this area, the indicator “access to Internet” is even higher. According to most surveys, Internet users in Bulgaria vary between 10 and 15% of the population and for understandable reasons most of these are located in the big cities. Unfortunately, these indicators are well below the desired ones for achieving a real information society.

Year	Internet hosts	Internet users	Internet users (% of population)	Number of computers (thousand)	Number of computers (%)
2000	18 429	430 000	5.27	361	4.43
2001	26 926	605 000	7.42	380	4.69
2002	32 986	630 000	7.73	405	5.19

Source: International Telecommunication Union ([www.itu.int](http://www.itu.int))

The Bulgarian sector of *information and telecommunication technologies* exhibits a positive trend in the period 2000-2002<sup>2</sup>. Net sales revenues for 2001 and 2002 account for over EUR 2 billion, almost a triple increase on 1998: about EUR 0.751 billion. The positive trend is the result of general knowledge and recognition of the advantages of ICT and hence higher demand for these services and products both from business and the government.

**Total ICT Net Sales Revenues**  
(mln. Euro)



At the same time, by expenses on telecommunication equipment and services as a share of GDP for 2003 Bulgaria exceeded EU member states and acceding states (Bulgaria's expenses are 9.2% of GDP). This indicator increases by some 0.8 percentage points per year (2000-2003), due to the greater interest in this sector in Bulgaria and its underdevelopment in the last century.

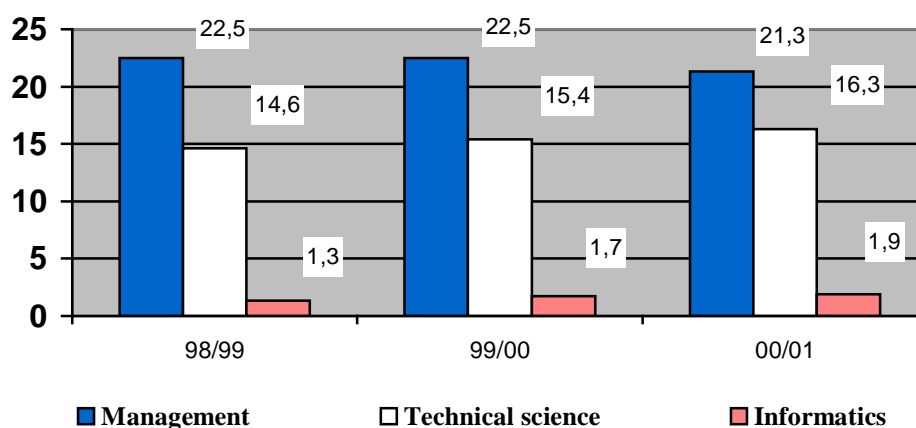
As regards expenses on IT as a share of GDP **Bulgaria is below the average level for EU and acceding countries** (2% against 3% and 2.7% respectively in 2003). The change for the period 2000-2003 is insignificant: 0.1 percentage point. This leads to the conclusion that obviously a sizeable amount of the increase in the production of ICT in Bulgaria is at the expense of exports abroad.

In terms of *education in the field of information and communication technologies* Bulgaria also marks a positive development. Currently there are 41

<sup>2</sup> Data provided by the NSI, processed by the Center for Economic Development on assignment by the Agency for Development of Communications and ICT.

universities in 26 cities. Many of these have set education in information and communication technologies as a priority. The number of students in the academic 2000/2001 is 44 646. About 16% of them do majors in technical sciences and about 2% in informatics and the trends over recent years exhibit upward trends.

**Share of students by majors to total number of students**



As a share of the population students graduating technical sciences in Bulgaria account for 7.9‰ in 2001 (aged 20-29). For 2000 this indicator is 6.6‰, or little above the average for acceding countries (6.3‰). In addition, good performance by Bulgarian students at international Olympiads in various technical fields is a proof of the quality of education which in turn is a condition for the successful implementation of the Lisbon goals.

### *Research and development*

Over the recent years **expenses on research and development in Bulgaria as a share of GDP exhibit a continuous decline**: from 1.64% in 1992 to 0.47% in 2001. A downward trend in this indicator evolved in the other acceding countries as well but it is less clearly pronounced. In most EU member states (and some future members) the period 2000-2001 is characterized by higher expenses on researches, which unfortunately is not the case in Bulgaria. This is one of the major problems to developing and introducing innovations in the country, which in turn will hinder quality and adequate performance of all the goals within the Lisbon Strategy.

Most sizeable expenses were made by scientific organizations and specialized institutes in the public sector (66.23%). Definitely, this is not the best way of carrying out such activity in the conditions of market economy. Only 27.1% of the activity is accounted for by private enterprises and from 1999 to 2001 this share is continuously decreasing. Definitely, one of the challenges faced by Bulgaria now is to follow adequate policy of encouraging private enterprises to do research and development. Only then will adverse trends reverse and the innovation potential of the country will grow.

## Toward Single Internal Market – Continuation of the Liberalization Process

### *Telecommunication sector*

The Bulgarian telecommunication sector was **officially liberalized** in early 2003 but a year later **BTC has no real competition yet**. Nevertheless, granting of five new licenses for building, maintaining and use of public telecommunication fixed telephone networks and provision of voice service as well as the privatization of BTC give hope that very soon there will be real competition on this market. After completion of the procedures for redistribution of the market with the entry of the new operators a new updating of the telecommunications act should be considered in line with EU directives in the area, adopted in 2003.

Currently three mobile operators are operating in the country (Mobitel, Globul and Mobicom). Mobitel dominates the market (about 2/3 of the total number of subscribers), followed by Globul (about 1/4 of the market) and Mobicom with a market share of approximately 5%. The first two operators use GSM standard while Mobicom communications are effected through the older NMT 450 standard: the reason for the small number of subscribers to this network. All operators have covered almost the entire population and provide access to their network to about 90% of Bulgaria' territory. A possible granting of a third GSM license in 2004 will boost market competition thus contributing to the supply of more and higher quality services at cheaper prices.

### *Energy sector*

Liberalization of the energy sector and other utilities is one of the main goals set out in the Lisbon Programme. Taking into account the crucial importance of gas and electricity markets, the European Union posed to the EU member states the requirement to *accelerate the processes of liberalization*. The time limits set in the directives on the gas and electricity markets conform to this requirement. According to them, as of 01.07.2004 all non-household consumers must be eligible. Member States shall ensure that all costumers are eligible from 01.07.2007. Another goal related to the establishment of a competitive internal market is the *reduction of state subsidies* for particular companies and sectors.

The later start of reforms and transition through periods of serious slowdown in restructuring predetermined the country's lagging behind in the context of the overall state of the utilities sector in the EU. This prompted the need for Bulgaria to currently pursue specific objectives, which will allow it to become an equal partner in building the single European market.

**Restructuring of the energy sector began in 2000** when the activity of NEC was divided into three – electricity production, transfer and distribution. Two years later the government adopted the Energy Strategy for Bulgaria, which outlines the future objectives of energy policy on the basis of which the sector will be reformed. Such an objective is to abolish the cross subsidizing of electricity prices for households by industrial enterprises. This is one of the main prerequisites for introducing market principles in the operation of the energy market in the country and setting off competition mechanisms. Progressive increases in the prices for households will end this year after reaching the price levels necessary to cover the costs for electricity supply. For the period 2000-2004 the funds allocated to the sector from the state budget are down by 60%. Parallel to the reduction of subsidies

allowances for heating were introduced targeted at the lowest social income bracket. Implementation of the schedule for abolishing subsidies reveals consistently pursued reforms in the sector, which is a good sign for the private investors in the Bulgarian energy sector.

In 2003 the State Energy Regulatory Commission (SERC) granted the status of eligible consumers to ten enterprises with annual electricity consumption of over 100 GWh. Initial liberalization accounted for about 15% of the total quantity of consumed electricity in the country. **Full opening of the electricity market** is envisaged with the country's accession to the EU in 2007 and the interim stages are not fixed yet. This is partly due to the necessity to deal with some functional problems on the market given the small number of participants. The lack of specific time limits creates uncertainty for the business and inhibits reporting and assessment of the liberalization progress. This does not allow enterprises to embed in their plans for development the conditions for electricity supply in which they will operate.

With the adoption of the Energy Act in 2003 the method of a regulated third party access to the network was introduced both in regard to the electricity and the gas sector. It defines clearly the function of the SERC<sup>3</sup> as a body that will consider claims about irregularities related to the implementation of the licensed activities of the companies in the energy sector. Pending is the adoption of regulations to determine the relationships between participants on the energy market.

In terms of the gas sector the Act provides for **liberalization of imports of natural gas** and traders and eligible consumers are entitled to enter into transactions independently with suppliers outside the country's territory. Currently the threshold for obtaining a status of eligible consumer is 80 million cub. m. annual consumption. As per the Act extracting enterprises may export independently natural gas to foreign customers provided they build their own gas pipelines to them. It should be noted that the gas distribution network for low-pressure consumers is at nascent stage of development. In the beginning of 2004 through a publicly announced tender the SERC granted licenses for the construction of gas distribution network in two out of the eight regions into which the country is divided. Actual gasification of low-pressure consumers could be expected not earlier than in the medium run, even if the process of granting licenses for gasification is intensified. This is due to the short length of the gas distribution network and the insignificant number of connected consumers at present.

The adopted Energy Efficiency Act is expected to have a positive effect on the competitiveness of the Bulgarian energy sector and the economy as a whole. It provides for a **consistent state policy in the area of energy efficiency** and implementation of energy efficient services. It is expected that implementation of this policy will help reduce the country's energy intensity which is well above the average in the EU.

Besides introducing market principles in the sector by changes in legislation, competition will be boosted by the **inflow of private capital**. In 2003 16.75% of the assets subject to privatization in the energy sector are already privately owned. Enterprises operating in maintenance and repair account for the highest share in privatization where 80% of the assets are already owned by private companies. Almost half of the power plants are privatized but only 7% of the mines are in private

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<sup>3</sup> The State Energy Regulatory Commission was established by Decree 181 of the Council of Ministers of the Republic of Bulgaria of 10/09/1999 pursuant to Art. 11, para. 2 of the Energy and Energy Efficiency Act (EEEA).

hands. The procedures for privatization of the seven state-owned electricity distribution companies are underway, expected to complete by the end of 2004.

### *Competition in the transport sector*

At this stage **there is no competition in rail and air transport**. There is an effective legal framework for rail transport, which provides for the right of third party access to the infrastructure while the legal framework for air transport is still at the stage of voting by the National Assembly. It should be noted that the great social importance of the reforms in the transport sector predetermines the weak political will for reform. This in turn inhibits building of a competitive environment.

In the area of *air transport reform* is sluggish. **The sector still suffers from lack of competition** both in terms of ground service and air traffic. Transposition of the European directives on air transport has not been effected yet to Bulgarian legislation. At this stage the country has a bill amending and supplementing the Civil Aviation Act, aimed to reflect the European directives in the area. Possible reasons for the lagging behind in the initiative "Single European Sky" may be the unstable market positions of the national carrier Bulgaria Air and efforts to ensure most favourable conditions for its financial stabilization. This increases the chance in a possible privatization of the company in the future to achieve better results. On the other hand, entry of foreign competitive aviation companies based on mutual agreements on air traffic remains blocked. This divests Bulgarian customers of the opportunity to use the services of low-cost airliners and fly at considerably cheaper prices.

Currently there is no competition on the *rail market* either. Infrastructure management activities were divided between two companies in 2002. So far they remain 100% state ownership. Accounting and administrative separation of transportation of passengers and cargo within the Bulgarian Railways is still pending. This is one of the obstacles for abolishing cross subsidizing between the two market segments. There is no progress in the reduction of state subsidies to the rail carrier. **The amount of annual subsidies stays high in absolute terms** and unchanged over the last three years. This is indicative of the slow pace of actual restructuring in the sector. Delay in reforms affects adversely the quality of provided services and reduces the potential of the sector as an alternative to road transportation of passengers and cargo. Although in 2000 the right to access to railway infrastructure was granted by law still there is no interest from private investors in carrying out transport business. The results of the invitation extended by the Ministry of Transport and Communications at the end of 2003 to 110 companies to participate in obtaining a license for private rail carrier are not announced yet. Reported growth in 2003 of transported cargo and passengers by 8.6 % and 4.4% respectively on the previous year may have a positive impact on the process.

Pursuit of decisive and consistent government policy will be the main factor behind the sector development in the future. One of the necessary conditions for successful completion of reforms will be attraction of foreign investments. In order for this to become reality, first of all accounting and management separation of the activities carried out in rail and air transport needs to be done. In turn this will allow identifying clearly the losing and profitable activities as well as the possibilities for their optimization. Separation will help stop cross subsidizing and put activities on market principles, a precondition for their successful privatization and granting on concession. These are only part of the measures which, combined with the processes

of liberalization, will help enhance the quality and efficiency of services in the transport sector and improve competitiveness in the country as a whole.

Bulgaria faces many challenges as it moves along the road to full accession to the single European market. Nevertheless, it can be stated that intensity of reforms is gradually growing to meet the EU Lisbon criteria at the time of accession.

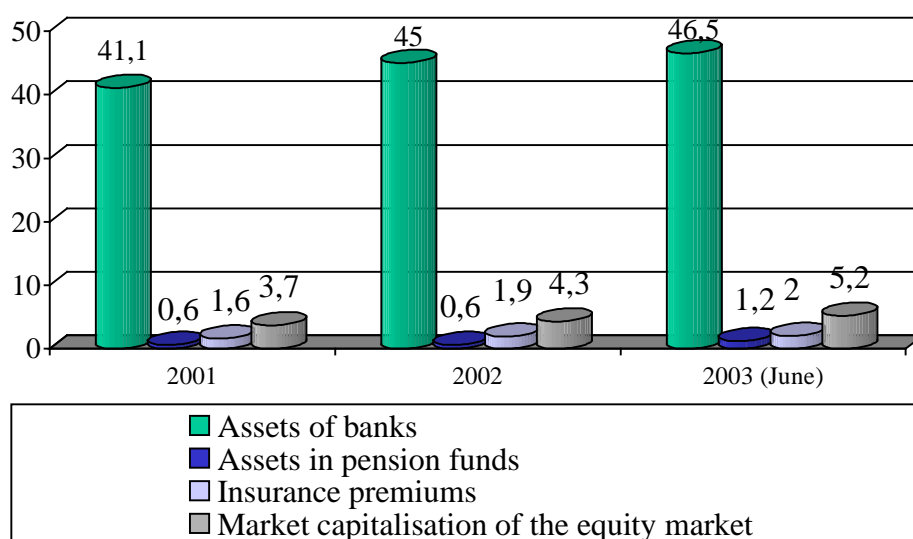
### *The fiscal services market*

The Lisbon Programme sets the goal of *improving efficiency and integration of European financial markets* and the conditions for funding. Specific measures in this area are formulated in the Financial Services Action Plan and the Risk Capital Action Plan. At this stage Bulgaria is solving other tasks associated with the accession to the EU like market liberalization, stabilization of the banking sector, and creation and development of an efficiently operating capital market.

One of the major steps in the context of liberalization of the financial services market in Bulgaria over the recent years is **privatization of commercial banks**. Attracting foreign capital through bank privatization led to recapitalization of Bulgarian banks and higher competitiveness in the financial sector. In practice bank privatization was completed in 2003 with the sale of DSK Bank. Currently 97% of total bank assets are private ownership and 85% are controlled by foreign investors.

At mid-2003 banks' assets in the country account for 46.5% of GDP and the upward trend of the past two years sustained.

**Financial intermediation in Bulgaria (% of GDP)\***

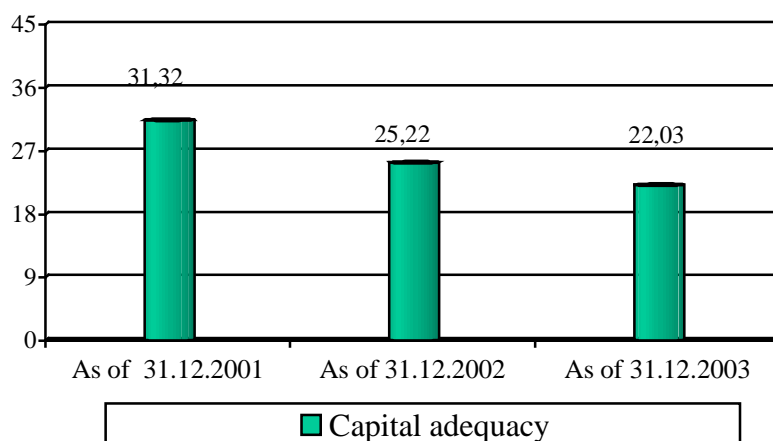


\*GDP for 2003 is an estimate.

Source: data from BNB, FSC, BSE and own calculations

Despite the lending expansion of the last year the **state of banks remains stable**, with excellent capital adequacy and liquidity indicators and well functioning bank supervision.

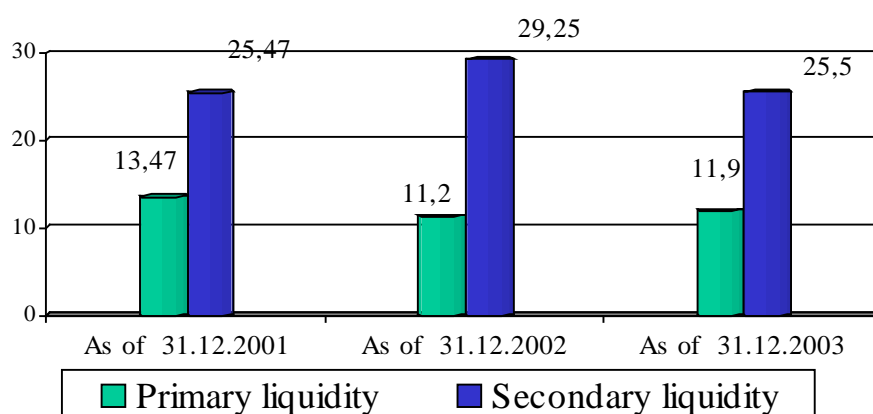
### Capital adequacy of commercial banks in Bulgaria (%)



\* Indicators do not include data on Group III banks.

Source: BNB data

### Liquidity indicators of the banking system (%)



Source: BNB data

Receivables from loans to the non-government sector continued the upward trend in 2003. Lending growth is expected to slow down in 2004 due to restrictive BNB measures (change in Regulation No. 9 on the evaluation and classification of risk exposures of banks and allocation of provisions for losses in terms of shortening the period from which a loan exposure starts to be deemed as doubtful or loss).

An efficiently operating capital market and well functioning financial intermediation is a necessary condition for enhancing the competitiveness of the Bulgarian economy and its successful integration to the Single Internal market. Despite the significant share of securities trade and market capitalization on the

Bulgarian Stock Exchange, **the role of the capital market in the Bulgarian financial sector is still insignificant** – as of end 2003 total market capitalization on the Bulgarian Stock Exchange – Sofia AD comprised 7.89% of the projected GDP for 2003<sup>4</sup>. The capital market is still an unpopular channel of financial intermediation in Bulgaria. Compared to Central and Eastern European countries by the share of market capitalization to GDP Bulgaria ranks last after Romania and the eight Eastern European countries joining the EU in 2004<sup>5</sup>. By market capitalization in absolute terms Bulgaria is also lagging far behind (Figures 3a and 3b, Appendix III). Existing market incentives are not sufficient for establishing good practices of corporate governance in some public companies. The state of the capital market does not result so much from the regulatory framework rather than the lack of good practices, knowledge and experience in borrowing funds through this channel. Investment alternatives are limited and **financial intermediation continues to be effected through the banking system**.

Finally we could summarize that following the financial crisis of 1996-1997 Bulgaria has established stable and favorable environment for the financial sector development. Effective legal framework is harmonized with the EU requirements and best international practices. Bank supervision operates efficiently. Despite certain underdevelopment in terms of financial products and services offered (in quality, quantity and value terms) the prospects for the Bulgarian financial sector are good. Further elaboration and harmonization of the national legislation with EU law in the area of payment systems, electronic settlements, out-of-court settlement of disputes between financial institutions and their customers and reporting requirements to the banks' units in Bulgaria is pending.

## **Encouragement of Entrepreneurship**

The Lisbon goals in the area of enterprise policy focus on four major directions:

- Improving environment for start-up and development of enterprises;
- Reducing administrative and regulatory barriers to business;
- Shifting state aid toward horizontal measures in support of enterprises;
- Applying efficient competition protection policy.

*Environment for start-up and development of enterprises in Bulgaria and reducing administrative and regulatory barriers to business*

**The small share of small and medium-sized enterprises (SME) in GDP** and in gross value added (GVA) compared to other Central and East European countries (CEE) entailed the need of active policy of promoting entrepreneurship in Bulgaria. In 2001 SME in Bulgaria account for only 17.8% of gross value added in the economy and in 2002 their share rose to 18.8%<sup>6</sup>. Compared to the contribution to GVA of all non-financial enterprises, the share of SME increased considerably:

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<sup>4</sup> Government Debt monthly bulletin, MoF, December 2003.

<sup>5</sup> According to EBRD data, Transition Report 2003.

<sup>6</sup> NSI and own calculations.



42.3% in 2001 and 45.6% in 2002.<sup>7</sup> Although growing, SME contribution to the Bulgarian economy is still well below the impact of SME on GDP in Lithuania, Latvia, Poland, the Czech Republic, and Hungary. The above-mentioned countries exceeded the 40% share of SME in GDP as early as mid 90's. In these countries the contribution of SME in employment is within the range of 45 and 55%<sup>8</sup>, while in Bulgaria it accounts for 49.8% (2002)<sup>9</sup>. These data reveal the need of reducing constraints to start-up of enterprises in Bulgaria and creating more favorable conditions for their development.

First, constraints refer mainly to the time and costs involved in starting up a business. Studies show that in Bulgaria the **time period and indirect costs<sup>10</sup> for starting up a business are considerably higher** than in EU: every entrepreneur in Bulgaria passes through 10 procedures and waits 30 days to register a company, while best practices in EU provide for European SME to pass through one procedure taking up to 3 days.<sup>11</sup> Moreover, over the past two years the procedures for business start-up in Bulgaria have not been eased up and convergence to European trends has been delayed. This refers primarily to the number of various administrative steps in the registration process. In Bulgaria they are 8, or close to the leading CEE countries: 6 in Hungary, 7 in the Czech Republic, and 8 in Slovenia. By comparison in Ireland, Great Britain and Finland these procedures vary between 1 and 3. At the same time Bulgaria outruns by these parameters EU member states with comparatively low GDP per capita like Greece and Portugal.<sup>12</sup> A conclusion may be drawn that **there is strong potential for improvement of the administrative environment for business start-up in Bulgaria**, the materialization of which requires investing more funds indirectly channeled to business, respectively improving the overall environment for business start-up. This conclusion is underpinned by the Global Competitiveness Report 2002-2003<sup>13</sup>, in which Bulgaria ranks 62<sup>nd</sup> by the indicator administrative barriers to business and 79<sup>th</sup> by the indicator administrative barriers to start-up companies (out of 102 countries), which shows significant potential for improvement of this indicator of the business environment in order to enhance competitiveness of Bulgarian companies.

Besides indirect costs for start-up of enterprises in Bulgaria, incurred as a result of the time for communication with the administration and the number of registration procedures, every economy captures direct costs as well. **To start up business in Bulgaria is comparatively cheap.** Direct costs for start-up in Bulgaria are estimated at EUR 132<sup>14</sup>, a good indicator for the countries that have joined the Lisbon Programme. Compared with income per capita however, these data suggest

<sup>7</sup> NSI and own calculations. Note: Calculations for 2001 and 2002 are made on defining the SME sector as an aggregate of all enterprises with payroll number of 1-249 persons inclusive. This is necessary to ensure comparability of data on the sector with those in EU and candidate countries.

<sup>8</sup> EBRD/World Bank. *Transition. The First Ten Years. Analysis and Lessons for Eastern Europe and the Former Soviet Union*. World Bank 2002, p. 42, 68

<sup>9</sup> NSI and own calculations.

<sup>10</sup> Indirect costs depend mainly on the time for communication of entrepreneurs with the administration, related to a specific number of registration procedures and conduct of business activity.

<sup>11</sup> OECD. *South East Europe Region. Enterprise Policy Performance: A Regional Assessment*. Oct. 2003, p. 28; see also Djankov, La Porta, de Silanes, Shleifer. *The Regulation of Entry*. The World Bank Policy Research Working Paper 2661, Aug. 2001, p. 38

<sup>12</sup> Djankov, La Porta, de Silanes, Shleifer. *The Regulation of Entry*. The World Bank Policy Research Working Paper 2661, Aug. 2001, p. 37-39

<sup>13</sup> World Economic Forum. *The Global Competitiveness Report 2002-2003*, p. 399

<sup>14</sup> OECD. *South East Europe Region. Enterprise Policy Performance: A Regional Assessment*. Oct. 2003, p. 28

potential for improving the measures in economic policy. For example, in Bulgaria the time and costs for start-up are estimated at about 25% of annual income, while in EU leading countries (in the context of fulfilling the Lisbon goals) like Ireland and Finland their share is reduced to 17 and 10%.<sup>15</sup> By these indicators Bulgaria outruns many CEE countries and some EU countries like Greece, Portugal and Spain.

As a result of these regulations the process of business start-up in Bulgaria is comparatively relieved but is still far behind the indicators of the best practices. A process of active start-up of new enterprises is underway in the country – between 15 and 20% new enterprises start up per annum as a share of existing enterprises.<sup>16</sup> Unfortunately there are no estimates about the number of enterprises that stay on the market more than three years in order to estimate the “net birth rate of enterprises” in Bulgaria.

At the end of 2003 new **measures in economic policy** were proposed, having the potential to encourage entrepreneurship. A serious step in this regard is the adopted Restriction of Administrative Regulation and Administrative Control on Economic Activity Act. Other measures are pending as well, but these have not been adopted finally by the National Assembly and they could encourage business start-up and development in Bulgaria by simplifying administrative barriers. These measure include: envisaged changes in the SME Act, a positive step toward reducing business costs in all stages of the life cycle of companies; the Bill on Encouragement of Investments in SME; the Bill amending and supplementing the Foreign Investments Act. The Encouragement of Scientific Research Act adopted in 2003 gives indications of support to the economic policy for creating new, knowledge-based economy in Bulgaria.

Additional improvements of the administrative environment to enhance competitiveness of Bulgarian companies and accelerate convergence of the Bulgarian economy to the Lisbon goals are required in the following areas: simplified employment and discharge of employees (to facilitate growth in enterprises); facilitating bankruptcy of enterprises (to facilitate transfer of resources to more productive businesses); introduction of alternative judicial practices (to facilitate contract implementation and cut costs of Bulgarian companies on contract performance); further facilitating access to funding and technologies through an option of SME listing on the Bulgarian Stock Exchange (BSE).

*Shifting from state aid toward horizontal measures in support of enterprises and applying efficient competition protection policy*

Granting state aid to given enterprises is not an utterly denounced method of enhancing competitiveness of companies, but it is losing importance. The share of the state aid in the economy is continuously decreasing, varying from 0.5% to 1.7% of GDP in EU economies. Though limited, measures in this respect shift from direct support to given enterprises to ensuring framework conditions for efficient market operation. The share of “horizontal” state aid to the total aid in EU is about 70% in

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<sup>15</sup> Djankov, La Porta, de Silanes, Shleifer. *The Regulation of Entry*. The World Bank Policy Research Working Paper 2661, Aug. 2001, p. 37

<sup>16</sup> European Commission. *Benchmarking Enterprise Policy*. Results from the 2002 scoreboard. Nov. 2002, p. 41

2001.<sup>17</sup> National commissions for protection of competition (CPC) play major role in the shift of approach.

With the change in the management team of CPC in Bulgaria in 2003 and changes in its principles of operation the impression that **CPC is increasingly becoming an active defender of competition efficiency in the country** was reinforced. Concurrently, reduced subsidies to particular economic sectors and intensified practice of tighter budget constraints to the state-owned enterprises are a positive step of the administration toward shifting away from state subsidies to horizontal measures in support of entrepreneurship.

The sectors of agriculture, fishery and transport should be excluded from these horizontal measures as they are subject to specific market regulations and impact by the European Commission by means of structural funds. By applying this specific measure a balance is sought between sector regulations in areas of higher social importance and horizontal measures in EU to stimulate efficient market operation.

Unsatisfactory utilization of pre-accession funds in Bulgaria, which prepare the ground for utilization of EU structural funds, is indicative of **still inadequate administration capacity** to ensure the balance between horizontal measures and sector regulations in Bulgaria. The lack of such balance generates inconsistencies in economic policy which should be overcome in the following years until Bulgaria's full membership to EU.

## **More and Better Jobs, Greater Social Cohesion**

Creating flexible and open labor markets is a key priority in achieving the Lisbon goals. The purpose is to create more and better jobs focusing on education and professional training. *Lisbon set the ambitious task by 2010 Europe to raise the overall workforce participation rates to 70 per cent, that for women to 60% and that for older workers to 50%.*

### *Encouragement of employment and fighting unemployment*

Eurostat data on 2002 show that the countries acceding the EU are still far behind from achieving this goal compared with present EU member states (55.9% against 64.3%). Unfortunately, **Bulgaria is the country with the lowest level of general employment** among acceding countries (50.6% in 2002). This shows that more efforts are needed to achieve the Lisbon goal.

An important priority in the Lisbon Strategy is taking measures to increase female employment, to improve their educational and qualification level and to ensure gender equality in economic, political and social life. Acceding countries are in a less favorable position compared to present EU member states by the indicator "female employment". In 2002 female employment in acceding countries is on average 50.1% against 55.6% in EU. **The level of female employment in Bulgaria is unsatisfactory: 47.5%.**

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<sup>17</sup> European Commission. *Benchmarking Enterprise Policy: Results from the 2003 Scoreboard*. Brussels 4.11.2003, SEC, p. 36. An important methodological clarification is needed here: in calculating state aid grants agriculture, fishery and transport are excluded, but grants in these sectors account for a sizeable share.

The Lisbon Strategy pays serious attention to the low levels of “*older workers employment*” (age 55-64). Adverse demographic trends, low level of employment of older workers and their low employability to the labor market both in EU member states and in acceding countries cause serious problems with the funding of the social insurance systems in these countries. Most of them have already taken steps for increasing the age of retirement and higher employability of older workers in view of their better integration to the labor market. Employment of older workers in EU member states is on average 40.1%, against 30.4% in acceding countries with great diversification in individual countries. By this indicator **Bulgaria occupies an intermediate position** among acceding countries with a level of older workers employment at 27%. Employment of older male workers is higher than employment of older female workers in present and future EU member states. This requires taking specific measures to increase first and foremost employment among older female workers. In Bulgaria employment of older female workers is a mere than 18.2% against older male workers employment of 37%.

Bulgaria’s transition from centrally planned economy to efficiently functioning market economy, started in the 90’s of the last century, caused overall restructuring of the economy and one of the negative effects is the presence of still high level of *structural unemployment*. Active government policy on the labor market reduced unemployment level from 16.4% in 2000 to 13.6% in 2003. According to Eurostat data, the level of **unemployment in Bulgaria is lower** than the average one for acceding countries (14.3%), but comparatively higher than the average one for the EU (8%). Unemployment among men in Bulgaria is 13.9% against 13.6% on average for acceding countries and 7.3% in the EU. On the other hand, unemployment among women (13.2%) is lower than the average one for acceding countries (15.1%), but comparatively higher than the average one in the EU (8.9%).

The main characteristics of unemployed in Bulgaria reveal the persons in an unfavorable position on the labor market in respect of whom specific measures should be taken for their successful integration to the labor market. The sustainable trend of higher share of registered unemployed women than registered unemployed men continued in Bulgaria. *The age structure of unemployed* reveals a relatively high share of unemployed youths up to the age of 29 and people aged over 50. *The education structure* of registered unemployed is still dominated by persons with primary and lower education. The adverse trend of long-term unemployed to prevail among registered unemployed continued (over 53% of all registered unemployed in 2003). These are persons who have lost their labor habits and skills and their low educational and professional qualification structure and low literacy additionally inhibit their reintegration to the labor market. Persons with primary and lower education make up 67.7% of long-term unemployed, and those without profession and specialty: 69.5%.

These *unequal groups* on the labor market are the main target groups to which employment policy will be directed in 2004, according to the **National Employment Action Plan for 2004**. The two main objectives of labor market policy in Bulgaria are to retain and increase employment and enhance employability and integration of unequal groups on the labor market. It is expected that these objectives will be achieved through implementation of four programmes: *Creating New Jobs and Preserving Existing Ones; Encouragement of Entrepreneurship; Increasing Labor Force Employability; Employment for Social Integration*.

Data on labor market development in Bulgaria show that the new strategy in social policy adopted by the government in 2002, based on a differentiated approach to every unemployed person, yields positive results but much more efforts are needed.

Conducting regular monitoring of labor force demand and supply on the labor market, developing new, more efficient employment programmes at national and local levels, adopting measures to stimulate professional training and qualification, encouraging entrepreneurship and entrepreneurial spirit, achieving better coordination between central and local authorities, professional associations and nongovernmental organizations in fighting unemployment, improving the dialogue between social partners are only some of the **measures which Bulgaria should take to ensure a more efficient functioning of the labor market** and higher competitiveness of the Bulgarian labor force.

### *Better education and qualification*

The labor market in Bulgaria still does not operate efficiently and the main reason behind this is the **non-reformed educational system which does not correspond to the new, services-oriented structure of the economy**. The high level of youth unemployment shows that the educational system does not prepare professionals with the skills and qualifications required by employers to achieve professional realization on the labor market. The lack of practical skills and experience makes youths noncompetitive on the labor market. Most unemployed are with primary and lower education and the only way for their reintegration to the labor market is to enhance their educational and qualification level.

**Acquiring higher education and qualification level by the labor force** is the way to achieving the Lisbon criteria for higher employment and productivity. The indicators by which the European Commission monitors the countries' progress in this area are "*share of youths aged 20-24 who have completed at least secondary education*", "*lifelong learning*" (share of persons aged 25-64 who have stated that they have received some form of education or training in the previous month), and "*share of those aged 25-64 who have completed at least secondary education*."

Countries acceding to the EU are closer to meeting the criterion – 85% of the people aged 20-24 will have secondary education by 2010. Eurostat data for 2003 reveal that on average for acceding countries this indicator is 88.3% against 74% on average for EU member states. Slovakia, the Czech Republic and Slovenia are the three countries in which over 90% of youths aged 20-24 now have secondary education. In 2003 the level of the indicator for Bulgaria (75.6%) is above the average one for the EU (74%). Regretfully, an adverse downward trend has been evolving since 2001 (78.2% in 2001, 77.5% in 2002 and 75.6% in 2003). On the other hand, the high level of youth unemployment indicates that the quality of the educational system does not correspond to the new market structure of the economy.

In acceding countries 81% on average of the population aged 25-64 have at least secondary education against 64.6% on average for the EU. Although the indicator for Bulgaria is 71.5%, well above the average for the EU, it lags far behind the other acceding countries. Only Romania and Hungary display worse results.

So-called "lifelong learning" is the most successful measure for enhancing competitiveness of a country's labor force. While on average 9.7% of the population in the EU aged 25-64 continues to enhance their education and qualification, in acceding countries 5.6% of the population in this age group does so. In Bulgaria only 1.4% of the population aged 25-64 continue to enhance their skills and qualification, which is one of the main reasons for the low level of general employment in the country.

**Spending on education in Bulgaria is still at the unsatisfactory some 4% of GDP**, and to improve the educational and qualification level of the labor force a reform of the educational system is needed. Attention should be paid to the fact that the new economy based on communications and information technologies requires a qualitatively new type of investment in human capital. **Greater consistency between educational, economic and social policies is needed** in order to encourage private investments in professional training and qualification and establish good public-private partnership in the field of education and professional training. By encouraging employers to accept youths who have just completed their education for internship youth unemployment will be reduced and the negative process of “brain drain” from Bulgaria will be halted. The more one invests in education, professional training and qualification and “lifelong learning” the more competitive he becomes on the labor market and therefore better paid.

#### *Better social protection and cohesion*

Adverse demographic trends and inefficient operation of labor markets in EU member states and acceding countries are the main reasons that led to painful reforms in the social insurance systems. The objectives set by the European Council in Lisbon in this field are: *ensuring long-term financial stability to the pension systems, increasing retirement age by 5 years (at 65) by 2010 and last but not least considerably reducing the number of persons exposed to the risk of poverty and social exclusion.*

The pension model in Bulgaria combining “pay-as-you-go” element (first pillar) with funded elements (second and third pillars) is considered to be **one of the most successful pension models** in Central and Eastern Europe. Through the first pillar the pension system ensures social protection to the whole population while the second pillar (supplementary compulsory pension insurance) and the third one (supplementary voluntary pension insurance) operate on a market principle.

Unfavorable demographic trends, the continuously growing deficit in the Pension Fund which is funded by a state subsidy from the budget and the high share of the shadow economy in the country which reduced social security contributions to the State Social Security funds were the main reasons for **introducing the minimum insurance thresholds by economic activity and profession** and compulsory registration of labor contracts with the National Social Security Institute (NSSI) in 2003. As a result of the new measures revenues to Social Security funds increased significantly in 2003 allowing for the introduction of higher ceiling on pensions (EUR 210 in 2004 against EUR 100 in 2003). Over the past two years major indicators characterizing the efficiency of operation of the pension system improved. These are: coefficient of dependence, coefficient of income replacement, collection rate, average pension per pensioner and expenditures on pensions to GDP.

<b>Major indicators of State Social Security development</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
<i>Dependency ratio, in %</i>	111.96	108.33	102.02
<i>Income replacement ratio, in %</i>	38.02	39.38	39.41
<i>Collection rate, in %</i>	90.14	96.69	98.20
<i>Average pension per pensioner, in BGN</i>	92.37	102.2	110.65

<i>Expenditures on pensions to GDP *, in %</i>	9.1	9.1	8.7
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Note: \*Data are from a MoF report on the 2004 State Budget Act

Source: NSSI and own calculations

**The social security burden in Bulgaria is still high**, but with the introduction of a more stringent control in labor and social security legislation it is expected to decline in the future. Raising the social security contribution from 2 to 3% in Universal Pension Funds in 2004 is assessed by experts in the field as a motivating measure for participation of the young generation in the social security system. Pension funds assets rose considerably in the recent years and at the end of 2003 they amount to EUR 250 million. Investment in pension funds is evaluated as a good investment decision.

Every year the retirement age for men and women increases by 6 months. The pension model provides for men to retire at the age of 63 and women at the age of 60. Bulgaria can achieve the Lisbon criterion for increasing the retirement age to 65 years by 2010 if measures are taken to increase employment of older workers and if public consensus is reached on this issue.

One way to reduce the number of people exposed to the risk of poverty and social exclusion is to **reduce regional differences in employment and unemployment and constrain long-term unemployment**. Despite the positive trend evolving since 2003 there is a great difference in the economic development of individual regions in the country, including in terms of the state of the labor market. To ensure more even economic development and social cohesion of individual regions in Bulgaria it is necessary to encourage development of regional employment programmes consistent with the specific economic and social conditions at local level.

The National Plan for Fighting Poverty and Social Exclusion for 2004 in accordance with the Strategy for Fighting Poverty and Social Exclusion adopted by the CoM in October 2003 is a decisive step toward achieving the Lisbon criteria in this area. It involves five strategic goals: *encouraging employment and increasing incomes; facilitating everybody's access to resources, rights, benefits, and services; preventing the risk of social exclusion; social support to vulnerable groups, families and persons; mobilizing all institutions*.

According to the latest UNDP Global Report on Human Development (2003) Bulgaria ranks second in the group of average developed countries. The human development index (HDI) for 2001 is 0.795, placing the country on the 57<sup>th</sup> place in a list of 175 countries included in the Report. This is a positive, though insignificant change on 2000, when Bulgaria ranked 60<sup>th</sup>.

## Conclusion

Overall, a conclusion can be drawn that the competitiveness of the Bulgarian economy is at a stage of transition from relatively short-term resource-driven competitiveness based on cheaper means of production to medium-term investment-driven competitiveness based on growing investments in technological innovation of production to achieve the standards and requirements of the European and global markets. For the time being the economy is still far away from ensuring long-term knowledge-driven competitiveness based on innovation, but in the next 3 years, while Bulgaria will be preparing for its accession to the EU, the legislative and institutional infrastructure for the transition to this type of competitiveness can be built. In terms of individual sectors, this means that very soon the capacity of competitive advantages of such industries like textiles, metallurgy and wood-processing will exhaust and the industries requiring more investments like energy, transport, tourism and agriculture will come to the fore, to reach eventually to such industries announced as long-term priority like telecommunications, software, various services (financial, banking, electronic, etc.). This will help achieve the objective of creating more and better jobs not so much in production, but in developing solutions, software for implementation of these solutions and services, based on higher level of intellectual skills and knowledge.

Bulgaria hopes to complete negotiations for accession to the EU within the mandate of the present Commission, i.e. before 2004. This is not impossible provided that commitments are fulfilled and time limits are met, as well as the necessary measures for timely removal of the shortcomings outlined in the latest progress report are taken. The firm commitment of the political administration, institutions and structures of civil society in Bulgaria to the steadfast implementation of economic restructuring and reforms in all spheres of social, political and economic life gives grounds to believe that in the remaining years to Bulgaria's accession to EU a significant progress will be made in catching up with achieving the Lisbon goals.

We have reasonable grounds to believe that the Bulgarian economy will continue its positive development typical of the recent years. Against the background of ongoing macroeconomic stability and global economic recovery a *relatively high gross domestic product growth* (about 5% for 2004) and improved values of a number of economic indicators is expected. In the report on Bulgaria adopted by the European Parliament in early March this year the focus is placed on four factors determining the prospect for accelerated economic growth: competitiveness of production, higher export potential, energy efficiency and security, and directing more investments in research.

The medium-term objectives of the Bulgarian government are directed toward achieving higher economic growth based on *higher volume of investments*. More active attraction of foreign direct investments is a key element of the process of catching up with the European economy. Efforts are directed toward improving the business climate to attract foreign investments as these are of key importance for its technological upgrade and transfer of new knowledge and know-how. Foreign investors competition on the domestic market will encourage higher technological standards of local producers, qualification of personnel and competitiveness of Bulgarian companies.



In the remaining three years to its accession to EU Bulgaria will have to create the necessary conditions for faster integration of transport, research and development networks in Europe. Reform in the Bulgarian education is at nascent stage and should be intensified not only to ensure the necessary growth and competitiveness of the Bulgarian economy but also to meet the European standards and common goals. Achieving consensus in the society on major issues of reform in education is still pending. The importance of the education system in the country for improving the educational and qualification level of the labour force in line with the requirements of the new economy, based on communication and information technologies, is increasingly growing. Achievement of public-private partnership will be crucial in outlining the directions of the reform.

The analysis shows that the country has achieved good results in some areas but given the very low starting point these results (though comparatively high against the background of the other EU member countries and the candidate countries) are quite insufficient. Hard efforts are needed to develop strategies, formulate policies and outline specific measures in all areas of economic and social life to converge to the EU member states and join successfully the Union.

Some sectors of the economy or certain ministries already have developed strategies for enhancing competitiveness. They set the priorities and goals as well as some major events for their implementation. What needs to be done in the short run is to achieve synergy among all strategies and plans for enhancing competitiveness in order to prevent failure of isolated actions, to reinforce their effect and to push through with the process.

Another direction of future purposeful efforts is integration of environmental issues in all spheres of the economy. The goal of *Sustainable Development* was added to the Lisbon Programme and based on the Strategy for Sustainable Development Bulgaria needs to develop its own plan for efficient use of natural resources and abolish the relation “economic growth - environment worsening”. It is necessary to speed up reforms in the context of better environmental protection and sustainable development as well as to develop a set of policies and measures for the achievement of this goal. Implementation of the environmental policy along with its adaptation to technical achievements and new knowledge should become a major goal by the end of this decade.